IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1944.

No. 380

CANADIAN RIVER GAS COMPANY, a Corporation, Petitioner,

v.

FEDERAL POWER COMMISSION, CITY AND COUNTY OF DENVER, COLORADO, PUBLIC SERVICE COMMISSION OF WYOMING, COLORADO-WYOMING GAS COMPANY, PUBLIC SERVICE COMPANY OF COLORADO, and COLORADO INTERSTATE GAS COMPANY, Respondents.

PETITION OF CANADIAN RIVER GAS COMPANY FOR REHEARING AND FOR ENLARGEMENT OF SCOPE OF REVIEW.

P. C. Spencer,
Room 2759, 630 Fifth Avenue,
New York, N. Y.;

Charles H. Keffer,
903 Fisk Building,
Amarillo, Texas;

John P. Akolt,
1300 Telephone Building,
Denver, Colorado,
Attorneys for Petitioner.

November, 1944.

EASTWOOD PRINTING CO., 2031 CURTIS STREET, DENVER

INDEX.

	PAGE
Petition for Rehearing and Enlargement of Scope of Review So As to Include Questions 1, 2 and 3 Presented in Petition for Writ of Certiorari	1, 2
Question No. 1	2
Reasons for Inclusion of Question No. 1 in Scope of Review	2-12
Question No. 2	13
Reasons for Inclusion of Question No. 2 in Scope of Review	13-18
Question No. 3	18
Reasons for Inclusion of Question No. 3 in Scope of Review	18-34
Certificate of Counsel	34

CITATIONS.

CASES:

A. T. & T. Co., et al., v. United States, et al., 299 U. S. 232, 240; 81 L. Ed. 842	27, 32
California Rice Industry v. Federal Trade Commission (C.C.A. 9, 102 Fed. (2d) 716)	5
Canadian River Gas Co. v. Federal Power Commission, 142 Fed. (2d) 952	10
Carter v. Carter Coal Co., 298 U. S. 238, 80 L. Ed. 1160	5
Corporation Commission of Oklahoma v. Champlin Refining Co., 286 U. S. 210, 76 L. Ed. 1062	4
Federal Power Commission v. Natural Gas Pipeline Co., 315 U. S. 575	3, 14, 30, 33
Federal Power Commission v. Hope Natural Gas Co., 320 U. S. 591	3, 14, 30, 33
Federal Trade Commission v. Bunte Bros. Inc., 312 U. S. 349; 85 L. Ed. 881	5
Heisler v. Thomas Colliery Co., 260 U. S. 245, 67 L. Ed. 237	

CITATIONS (CONTINUED).

PAGE

Hope Natural Gas Co. v. Hall, State Tax Commissioner of West Virginia, 274 U. S. 284, 71 L. Ed. 1049 5

Jersey Central Power & L. Co. v. Federal Power Commission, 319 U. S. 61, 87 L. Ed. 1258 5

A. B. Kirschbaum v. Walling, 316 U. S. 517, 86 L. Ed. 1638, 1646 5

National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U. S. 1, 81 L. Ed. 893 5

New York Telephone Co. v. United States, et al. (Decided Aug. 24, 1944, Opinion not yet published) 27, 28, 32

Niagara Falls Power Co. v. Federal Power Commission, 137 Fed. 787, 793-794 .... 28, 29

Oliver Iron Mining Co. v. Lord, 262 U. S. 172, 67 L. Ed. 929 5

Pennsylvania Power & Light Co. v. Federal Power Commission, 139 Fed. (2d) 445 26

Public Utilities Commission of Ohio v. United Fuel & Gas Co., 317 U. S. 456, 87 L. Ed. 1162 6

Sunshine Anthracite Coal Co. v. Adkins, 310 U. S. 381, 84 L. Ed. 1263 5

Thompson v. Consolidated Gas Utilities Corp., 300 U. S. 55, 81 L. Ed. 510 5

United States v. F. W. Darby Lumber Co., 312 U. S. 100, 85 L. Ed. 609 5

Walling v. Jacksonville Paper Co., 317 U. S. 564, 87 L. Ed. 460 5

STATUTES:

Natural Gas Act of 1938 (52 Stat. 821, 15 U.S.C., Sec. 717)

Sec. 1(a) 2

Sec. 1(b) 3

Legislative History—Production and Gathering 3

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1944.

No. 380.

CANADIAN RIVER GAS COMPANY, a Corporation,
PETITIONER,

v.

FEDERAL POWER COMMISSION, CITY AND COUNTY OF DENVER, COLORADO, PUBLIC SERVICE COMMISSION OF WYOMING, COLORADO-WYOMING GAS COMPANY, PUBLIC SERVICE COMPANY OF COLORADO, and COLORADO INTERSTATE GAS COMPANY, RESPONDENTS.

PETITION OF CANADIAN RIVER GAS COMPANY FOR REHEARING AND FOR ENLARGEMENT OF SCOPE OF REVIEW.

Canadian River Gas Company, petitioner, heretofore filed its Petition for Writ of Certiorari herein presenting nine separate questions. By its Order of November 13, 1944, this Court granted said petition, limited to the Eighth Question presented thereby, which Eighth Question is as follows:

"8. Whether the Commission can, consistently with the Fifth Amendment to the Constitution of the United States and the provisions of the Act, reduce the rates and charges of Canadian on that part of its natural gas sales to Colorado Interstate which is not sold by the latter for ultimate distribution to the public but is sold by it directly to its industrial customers; furthermore, independent of

the above question, whether the Commission erred in making no separation or allocation as between Canadian's properties devoted to intrastate sales in Texas and its properties devoted to interstate sales, or as between the properties of Canadian and the properties of Colorado Interstate, and in using in lieu thereof a substitute method of allocation of cost of service which results in burdening non-regulable gas with costs actually chargeable against regulable gas, in violation of the Fifth Amendment to the Constitution of the United States and the Act."

Petitioner now respectfully petitions this Court to grant a rehearing herein to the extent that its Order of November 13, 1944, denies review by this Court of Questions 1, 2 and 3 set forth in its Petition for Writ of Certiorari, and to enlarge the scope of the review to be had in this Court so as to include the Questions Nos. 1, 2 and 3, as well as the Question No. 8 set forth in said Petition for Writ of Certiorari.

In support of this petition, petitioner respectfully shows:

QUESTION NO. 1.

Question No. 1 set forth in the Petition for Writ of Certiorari is as follows:

"1. Whether the Circuit Court, after correctly holding that the Commission has no rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, erroneously concluded and ruled that the Commission in this case did not exercise such prohibited jurisdiction."

Petitioner believes and submits that in failing to include this question within the scope of its granted review this Honorable Court has overlooked or misapprehended the public importance and real significance of the question presented, all of which is evidenced by the following brief summary statement of facts:

(a) Section 1(a) of the Natural Gas Act declares the Congressional intent and sets forth the purposes of the Act "that the business of *transporting and selling* natural gas for ultimate distribution to the public is affected with a pub-

lic interest, and that Federal regulation in matters relating to the *transportation* of natural gas and the *sale* thereof in interstate and foreign commerce is necessary in the public interest."

(b) Not only does the Act by Section 1(a) limit its scope and coverage to interstate transportation and sale of natural gas, but to foreclose all possibility of misconstruction or an unwarranted assumption of non-granted jurisdiction Section 1(b) of the Act expressly provides that it "shall not apply to * * * the production or gathering of natural gas." Clearly the English language contains no words which could more positively express the Congressional intent than are found in these two subdivisions of the very first section of the Act.

(c) If aid to interpretation of the clear, positive and unambiguous language contained in Sections 1(a) and 1(b) of the Act is for any reason thought necessary or desired, it can be abundantly found in the legislative history of the Act where its sponsors, including the representatives of the Federal Power Commission, stated time and time again that the Act was not designed to and did not cover production and gathering. See statements of Mr. Dozier A. DeVane and Mr. Thomas J. Tingley, Solicitor and Assistant Solicitor, respectively, of the Federal Power Commission contained in the official report of "Hearing Before a Sub-Committee of the Committee on Interstate and Foreign Commerce, House of Representatives" in connection with the original H.R. 11662, pages 17, 28, 34, 35, 42, 43; statements of Chairman Lea, Congressional Record, Volume 81, Part 6, page 6721; and Senator Wheeler, Congressional Record, Volume 81, No. 162, page 11981.

(d) This Court, in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. 575, and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U. S. 591, has approved actions of the Commission only because the Commission was found to have acted within the "ambit of its authority," and in the Hope Case (p. 287, Vol. 88 L. Ed. Advance Opinions) this Court stated:

"As we have said, the Act does not intrude on the domain traditionally reserved for control by state commissions;

and the Federal Power Commission was given no authority over "the production or gathering of natural gas.'"

(e) The Circuit Court of Appeals for the Tenth Circuit in its opinion in this case (142 Fed. (2d), p. 952), following the mandate of the Act and the ruling of this Court, correctly stated that "under Section 1(b) the Commission does not have express or implied rate regulatory jurisdiction of the production and gathering of gas," and that under Section 1 of the Act the production and gathering properties and facilities of petitioner, while part of its integrated operations, "lie beyond the range of the rate-regulatory jurisdiction of the Commission."

(f) In view of the express and positive provisions of the Act, the legislative history thereof, the ruling of this Court in the Hope Case quoted above, and the quoted language from the Circuit Court's opinion, we are absolutely unable by recourse either to reasoning or imagination, to justify the lower court's ruling that what the Commission did in this case does not constitute a usurpation of rate regulatory jurisdiction over production and gathering so universally recognized as being expressly withheld from the Commission. The Commission itself makes no contention that it has not exercised rate regulatory jurisdiction over Canadian's production and gathering, but attempts to justify its action on the theory that an exercise of such jurisdiction is essential, although not granted by Congress, to a proper exercise of its delegated rate regulatory jurisdiction over interstate transportation and sale of natural gas. That this contention is without merit and that the Commission did in this case exercise prohibited rate regulatory jurisdiction over production and gathering are demonstrated by the following:

(g) Mining operations, which would include production of natural gas, have been uniformly held by this Court to be local in nature and not to constitute interstate commerce even though the product mined is destined to be shipped in interstate commerce.

Corporation Commission of Oklahoma v. Champlin Refining Co., 286 U. S. 210, 76 L. Ed. 1063.

Thompson v. Consolidated Gas Utilities Corp., 300 U. S. 55, 81 L. Ed. 510.

Heisler v. Thomas Colliery Co., 260 U. S. 245, 67 L. Ed. 237.

Oliver Iron Mining Co. v. Lord, 262 U. S. 172, 67 L. Ed. 929.

Carter v. Carter Coal Co., 298 U. S. 238, 80 L. Ed. 1160.

Hope Natural Gas Co. v. Hall, State Tax Commissioner of West Virginia, 274 U. S. 284, 71 L. Ed. 1049.

Jersey Central Power & L. Co. v. Federal Power Commission, 319 U. S. 61, 87 L. Ed. 1258.

(h) The fact that the production and gathering may affect interstate commerce does not vest rate regulatory jurisdiction in the Commission over production and gathering as the Natural Gas Act is different from other acts adopted in recent years which vested jurisdiction in commissions where the subject-matter of the act "affected" or "burdened" or "obstructed" interstate commerce:

National Labor Relations Board v. Jones & Laughlin Steel Corp., 301 U. S. 1, 81 L. Ed. 893. (National Labor Relations Act)

Sunshine Anthracite Coal Co. v. Adkins, 310 U. S. 381, 84 L. Ed. 1263. (Bituminous Coal Conservation Act)

United States v. F. W. Darby Lumber Co., 312 U. S. 100, 85 L. Ed. 609. (Fair Labor Standards Act)

Federal Trade Commission v. Bunte Bros., Inc., 312 U. S. 349, 85 L. Ed. 881. (Federal Trade Commission Act)

California Rice Industry v. Federal Trade Commission, (C.C.A. 9, 102 Fed. (2d) 716.) (Federal Trade Commission Act)

A. B. Kirschbaum v. Walling, 316 U. S. 517, 86 L. Ed. 1638, 1646. (Fair Labor Standards Act)

Walling v. Jacksonville Paper Co., 317 U. S. 564, 87 L. Ed 460. (Fair Labor Standards Act)

Public Utilities Commission of Ohio v. United Fuel Gas Co., 317 U. S. 456, 87 L. Ed. 1162. (Federal Power Commission)

While Congress may have the power to regulate matters *affecting interstate commerce* as well as matters *in interstate commerce*, all the above cases make it absolutely clear that Congress does not have to exercise its full power, and that where it only delegates jurisdiction over matters *in interstate commerce*, such jurisdiction cannot be extended so as to include matters which may be said to *affect interstate commerce*. It is for Congress, and not for the created commissions or the courts, to decide what jurisdiction should be delegated, and, as stated by the lower court in its opinion in this very case, "the Commission does not have *express or implied* rate regulatory jurisdiction of the production and gathering of gas."

(i) As found by the Commission, (R., V. 1, p. 143), as of December 31, 1939, Canadian held gas leaseholds on approximately 300,000 acres of land located in the Texas Panhandle Field in the State of Texas on which it had in operation a total of 94 gas wells. Its gathering system consists of 144 miles of various size of pipe, all located in the State of Texas. The gathering system has two termini. One terminus is located in what is known as the Bivins Station in the State of Texas. At this point the gas there gathered is compressed and then transported by Canadian through its own transmission pipe line to Clayton Junction, near Clayton, New Mexico, at which point it sells the gas so transported to Colorado Interstate Gas Company, and the latter company then transports such gas through its "Denver Line" and sells the same at various points in the State of Colorado. The other terminus of Canadian's gathering system is located at what is known as Fritch Station, also in Texas. At this point the gas there gathered is compressed and then transported by Canadian through facilities leased from Texoma Natural Gas Company to a point in Oklahoma known as Gray Junction where the gas so transported is also sold to Colorado Interstate Gas Company.

As shown from the above and as stated by the Commission in its Opinion (R., V. 1, p. 143), it thus appears that

Canadian is engaged in several different and distinct business operations or functions: (a) Production, (b) gathering, (c) transportation, and (d) sale of natural gas. In addition to the sale of natural gas to Colorado Interstate at Clayton Junction, New Mexico, and at Gray, Oklahoma, Canadian also sells natural gas to Amarillo Oil Company at the wells in the field for the cities of Amarillo and Channing, Texas, and along its pipe line for the Dalhart, Hartley and Texline, Texas, markets. It also sells a quantity of gas to Clayton Gas Company, with deliveries at the Clayton, New Mexico town border. (R., V. 2, p. 708)

The gas sold by Canadian to Colorado Interstate is so sold pursuant to a term contract between the two companies, dated January 3, 1928. (Ex. 16, R., V. 2, pp. 711-780) It is the compensation which Canadian is entitled to receive under this contract which, among other things, includes the price of the gas, which the Commission, by its rate reduction order, requires to be reduced in the amount of $551,000 annually. Among other things, this contract, known as the Cost Contract, for the compensation therein provided to be paid Canadian and which compensation has been reduced to the extent above stated by the Commission's order, requires Canadian to acquire, maintain and develop a substantial block of gas leaseholds, to drill and operate wells, to construct and operate gathering facilities, to pay off funded debt in fixed amounts at fixed times, and to sell gas to others only as permitted by Colorado Interstate.

(j) An important fact in consideration of the question presented is that there is a commodity market value for Canadian's natural gas in the field where produced and at the end of the gathering system termini. The uncontradicted evidence in this case introduced by Canadian's witnesses (R., V. 6, pp. 3256, 3280) and corroborated by the Commission's own witness (Ex. 168, Sheets Nos. 113, 114, and 127; R., V. 6, p. 3281) establishes the market value of Canadian's gas at the wellhead in the field at 4c per Mcf. (16.4-pound pressure base) and the fair market value of natural gas gathered and delivered at the Bivins Station (one end of the gathering system termini and the beginning of the transportation system) to be 7c per Mcf.

We respectfully but earnestly submit that the Commission could keep within its delegated jurisdiction over interstate transportation and sale and not usurp an undelegated jurisdiction over production and gathering by using the commodity value of Canadian's natural gas at the end of the gathering system which is the beginning of the interstate transportation system as its jurisdictional starting point. The existence of a commodity value of the gas is in itself a complete answer to the Commission's contention that rate regulatory jurisdiction over the production and gathering properties, facilities and business, although withheld by Congress, is essential to an exercise of its delegated rate regulatory jurisdiction over interstate transportation and sale. So this case, or any similar case, need not be approached with the apprehension that if the Congressional mandate is followed and the Commission denied the right to exercise rate regulatory jurisdiction over production and gathering, the Commission will be unable properly to fulfill its delegated duties over interstate transportation and sale.

(k) As indicating the all-inclusive jurisdiction exercised by the Commission in this case over all of Canadian's properties, facilities and business, including not only its interstate transportation and sale but also its production and gathering, the following is noted which appears in the record in this case:

1. In arriving at its rate reduction order the Commission determined a rate base which includes not only Canadian's interstate transmission system but also its production and gathering properties. (R., V. 1, pp. 144-195; V. 5, pp. 2717-2721)

2. In determining its rate base for Canadian's producing and gathering properties the Commission applied its so called original cost or prudent investment theories and in so doing totally ignored the true value of such properties as well as the actual cost thereof to Canadian.[1]

[1] The Commission deducted $3,864,357 from Canadian's original cost, practically all of which is applicable to leaseholds. (R., V. 1, pp. 149-151) This is discussed under "Question 3" infra. The Commission included Canadian's bare leaseholds in its original cost rate base at a value of something less than $1,000,000 and in so doing totally ignored uncontradicted evidence of the present market value of such leaseholds in excess of $15,000,000. (Ex. 181, R., V. 6, pp. 3181-3254; Ex. 146, Sheets 62-64; R., V. 5, pp. 2717, 2721; R., V. 1, p. 186.)

3. In its rate base for production and gathering properties the Commission determined and included an allowance for working capital which it deemed sufficient to enable Canadian to carry on its production and gathering operations, and likewise the Commission has purported to determine in its rate base for production and gathering properties what additional wells should be drilled and what additional gathering facilities should be installed in the future. (R., V. 5, pp. 2530-2556)

4. After finding Canadian's total rate base to be $9,375,000 (R., V. 1, 187), of which approximately two-thirds represents production and gathering properties, (R., V. 5, 2717-2721), (even on the Commission's basis of determining a rate base), the Commission then found that Canadian was entitled to a return of 6½% per annum upon its total rate base (R., V. 1, 187), more than two-thirds of which, as above stated, is attributable to the hazardous business of discovering, exploring, developing and operating natural gas production properties.

5. The Commission has determined and made an allowance for Canadian's total annual operating expenses (including depreciation and depletion), the greater portion of which represents the cost of producing and gathering natural gas. (R., V. 1, 171; V. 4, 2341-2345).

6. After determining the total annual income of Canadian from all sources, the greater portion of which represents the cost of producing and gathering natural gas under its Cost Contract with Colorado Interstate, the Commission has deducted its determined annual operating expenses (mostly production and gathering) from such total income, and then, after making a return allowance of 6½% upon its determined rate base (mostly production and gathering), it has found an alleged excess income being received by Canadian, which forms the basis for its rate reduction order.

7. The Commission's order changes and abrogates the amount of compensation which Canadian is entitled to receive from Colorado Interstate under its Cost Contract, which compensation represents cost reimbursement to Canadian not only for the cost of current deliveries of gas to

Colorado Interstate, but also for the cost of performing various other services under the Cost Contract relating to Canadian's production and gathering properties and operations, such as the maintenance of leaseholds, the drilling of wells and the construction of gathering facilities as directed by Colorado Interstate.

(4) Notwithstanding all of the above and its own ruling that the Commission does not have either express or implied rate regulatory jurisdiction over production and gathering, the Circuit Court in its Opinion (142 Fed. (2d), p. 952) sustained the Commission's rate reduction order upon a novel theory stated as follows:

> "Canadian is engaged in the business of producing, gathering, transporting and selling interstate natural gas for resale for ultimate public consumption. It therefore is a natural gas company, subject to the jurisdiction of the Commission in respect to its rates and charges for the gas transported and sold in such commerce. Its production and gathering properties and facilities are parts of its integrated operations. Still, under section 1 of the Act they lie beyond the range of the rate-regulatory jurisdiction of the Commission. But the Commission did not prescribe charges for the production; did not fix rates for the gathering of gas; and did not exercise other rate-regulatory jurisdiction over production or gathering as such, within the meaning of the limiting and forbidding provisions of the Act. The Commission did not attempt to affect in any manner the acquiring and maintaining of gas leaseholds, gas rights, or gas wells. Neither did it undertake to affect anywise the location, construction, extension, or physical connections of pipelines, or the operation of pipelines or other facilities constituting the gathering properties. The rate-regulatory jurisdiction of the Commission was exerted only in respect to rates and charges for natural gas transported in interstate commerce and sold in such commerce for resale for ultimate public consumption. The Commission inquired into and considered the production and gathering properties in respect to cost, depreciation, operating expenses, and revenues. But the inquiry was merely in their relation to the fixing of rea-

sonable rates to be exacted and received for the natural gas moved in interstate commerce and sold for resale. And the order of the Commission in each instance operated only upon such rates and charges. We fail to find in the act anything which expressly or by fair implication indicates a Congressional purpose to restrict or withhold from the Commission jurisdiction in a case of this kind to take into consideration the production and gathering properties only as they have bearing upon the question of the fixing of reasonable rates for gas moved interstate and sold for public consumption.'" (Pages 952, 953)

The Commission itself, either in its own Opinion or in its briefs filed in the Circuit Court or in this Court in connection with the petition for writ of certiorari, contends for no such theory, but boldly admits that it did exercise rate regulatory jurisdiction over Canadian's production and gathering and claims to possess such jurisdiction.

We respectfully submit that while the Circuit Court in one breath nominally purports to reject the Commission's jurisdictional contention, it does in its final and effective breath sustain the Commission's position notwithstanding the clear and positive provisions of the Act and the holding of this Court in the Hope Case. We submit it approaches absurdity to state that the Commission does not have rate regulatory jurisdiction over production and gathering and at the same time to rule that rate regulatory jurisdiction is not exercised where the Commission includes production and gathering properties in a rate base; where it applies its own formula of original cost or prudent investment to production and gathering properties; where it includes production and gathering expenses in its estimate of future expenses; where it allows working capital for the production and gathering business, and considers and determines what wells are to be drilled in the future; and finally, where, in determing an alleged excess revenue, it applies a 6½% rate of return not only to the transmission system properties but also to the production and gathering properties which constitutes approximately two-thirds of the total rate base as determined by the Commission. Obviously the Commission has treated every element of Canadian's production and gathering prop-

erties, facilities and business in precisely the same manner as its interstate transmission properties, facilities and business, and has subjected every element of Canadian's production and gathering facilities to the same rate regulatory measures and procedures as Canadian's interstate transmission properties, facilities and business for the purpose of arriving at its ultimate conclusions with respect to rates and charges. If the Act had expressly delegated full and complete rate regulatory jurisdiction over Canadian's producing and gathering properties, facilities and business, the Commission could have done no more than it has done in this case. The Circuit Court's opinion is inconsistent and contradictory. Its effect, not only in the instant case but also in all other cases, if allowed to stand, is to vest complete rate regulatory jurisdiction over production and gathering and thus to assume and exercise a legislative veto power over an express and unambiguous Act of Congress.

We again emphasize that natural gas is a commodity; that the market value of that gas as a commodity at the wellhead and at the end of Canadian's gathering system, which is the beginning of its interstate transmission system, was established by uncontradicted evidence. The whole theory and purpose of the Act and the express Congressional intent set forth therein can be sustained, served and followed if this established commodity value of the natural gas be used as the starting point of the Commission's jurisdiction. In such event by using that commodity value as its jurisdictional starting point the Commission can properly proceed with an exercise of its delegated rate regulatory jurisdiction over the interstate transportation and sale of that gas.

In conclusion we urge that the Commission's action in this case and the Circuit Court's affirmance thereof are in direct conflict with the Act and with the opinion of this Court in the Hope Case, and that the matter is of such great public importance not only to the natural gas industry itself but also to the public at large that this obvious unwarranted assumption of jurisdiction on the part of the Commission should not be allowed to become the law of the land without at least a consideration of the matter by this Court.

QUESTION NO. 2.

Question No. 2 set forth in the Petition for Writ of Certiorari is as follows:

"2. Whether, even assuming, arguendo, that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, the Commission can, consistently with the Fifth Amendment to the Constitution of the United States, the requirements of the Act, and the decisions of this Court in the Natural Gas Pipeline, Hope and other cases, limit Canadian generally to a return only on the 'wildcat' or original cost of its gas leaseholds to predecessor companies prior to discovery and development over 20 years ago, to the exclusion of all evidence of value, market or otherwise, the result of this procedure being, among other things, the inclusion in the Commission's rate base of a substantial block of Canadian's most valuable leaseholds at zero valuation and a still larger block of valuable leaseholds at only 10¢ per acre valuation."

It is our definite position, raised in Question No. 1, that the Commission does not have rate regulatory jurisdiction over the production and gathering of natural gas and that its delegated jurisdiction over interstate transportation and sale can fully, adequately and properly be exercised by determining the commodity value of the natural gas at the end of the transmission system, which is the beginning of the interstate transportation. This clearly was the Congressional intent in expressly withholding rate regulatory jurisdiction over production and gathering from the Commission. Such a logical and practicable procedure would render it unnecessary to rely upon the inconsistent and contradictory subterfuge found in the Circuit Court's Opinion quoted above which denies jurisdiction and upholds Congress with one hand and at the same time legislates jurisdiction and thwarts Congress with the other hand.

Even, however, if it be assumed, arguendo, that by whatever name it may be called, rate regulatory jurisdiction is to be exercised over production and gathering, still we submit it is entirely improper for various reasons hereinafter men-

tioned ~~to include~~ natural gas leaseholds in a rate base at original cost and to allow a return based upon such original cost.

We are not arguing here the question as to whether for the ordinary class of public utility property, original cost or something else should be the foundation of the rate base. Natural gas leaseholds constitute a class of property unique in itself and what may be a permissible or logical theory of a rate base for the ordinary utility property can have no proper application to gas leaseholds. Certainly there is nothing in the Natural Gas Act which requires the Commission to use original cost in including natural gas leaseholds in a rate base, even assuming that the Commission has rate regulatory jurisdiction over those leaseholds. Again, when this Court in the Natural Gas Pipeline and Hope cases stated that the Commission is not bound to any single formula or combination of formulas, it certainly did not intend to limit the Commission to an original cost formula in all cases. On the contrary, the "end result" and "rate impact" principles announced by this Court in these two cases would seem to make it absolutely clear that an original cost rate base as applied to natural gas leaseholds is not only in conflict with the basic theory of the Natural Gas Pipeline and Hope cases but condemned by the "rate impact" and "end result" principles announced therein.

We submit that, except in an isolated instance as the result of accident, an original cost rate base as applied to natural gas leaseholds can never be fair to either the owner of the leaseholds or the public, and cannot, except accidentally, result in just and reasonable rates, as required by the Act. This can be demonstrated by a few general examples before coming to the particular situation which exists in the instant case.

A gas company, with \$10,000,000 capital to spend in attempting to secure production, spends \$9,000,000 of it around the country in geologizing, leasing, drilling and related matters, without success. With its last million dollars it acquires some leaseholds which prove productive. Under the Commission's original cost theory the company would be limited to a 6½% return on this last million dollars. No

consideration at all is given to the fact that it actually cost the company $10,000,000 to secure this one producing field. Such a theory must necessarily retard, if not eventually entirely terminate, attempts to locate and develop new fields to the obvious prejudice of the general public.

Again, A and B acquire adjoining gas leasehold acreage of the same size: A, at a cost of $1,000,000; B, at a cost of $100,000. Both prove productive. The gas produced from each as a commodity and on a competitive basis is of the same market value. Under the Commission's original cost theory A will be allowed a 6½% return on $1,000,000, and B a 6½% return on $100,000, and thus as far as the inclusion of the leaseholds is concerned, the consuming public will be required to pay ten times as much for A's gas as for B's, even though they both have the same market value.

A final example: A, mentioned above, with his $1,000,000 investment, develops a property containing a reserve of, say 10,000,000 Mcf. B, with his $100,000 investment, develops a reserve of 50,000,000 Mcf. Certainly, notwithstanding the difference in the investment or original cost, B's property is much the more valuable, and yet again, under the Commission's original cost theory, B will be limited to a 6½% return on his $100,000 as against ten times that much for A.

We submit that such a blind application of the Commission's original cost theory is unsound, impracticable, violative of the Fifth Amendment, must necessarily result in untold confusion, and cannot possibly result in just or reasonable rates either from the viewpoint of the owner of the leaseholds or the consuming public.

Of course, as we have urged above, this whole question can be avoided and order brought out of chaos if the Commission shall be held to its delegated jurisdiction and not attempt to include production and gathering properties in a rate base, but use the market value of the gas as a commodity as its jurisdictional starting point.

Other facts pertinent to this question and relating to Canadian's general picture are set forth infra in connection with "Question No. 3". Without citing or quoting the detailed evidence, we call attention to the following which ap-

pears from the record in this case clearly showing the impropriety, if not the illegality and unconstitutionality, of including natural gas leaseholds in a rate base at original cost.

An analysis of the testimony of Commission witnesses, which the Commission adopted substantially (Ex. 146, Sheets 62-64; R., V. 5, 2717-2721), shows that the Commission used the sum of $1,604,020.61 as the starting point for its findings as to original cost of or investment in Canadian's leaseholds as of December 31, 1939. Then, as appears from Paragraph 8 of the Commission's formal findings (R., V. 1, 186), a deduction of $653,681 was made for depletion. This means that Canadian's bare leaseholds have been included in the Commission's original cost rate base at a value of something less than $1,000,000.

In adopting this valuation for rate base purposes, the Commission has wholly ignored substantial and uncontradicted evidence that "the present market value of Canadian's leaseholds" (excluding wells) is the sum of $15,646,787.64. This evidence is the testimony of Canadian's witness Wallace. (Ex. 181; R., V. 6, 3181-3254).

The Commission has found that Canadian's recoverable gas reserves are 2,800,000,000 Mcf. (R., I, 159). Reducing these figures so found by the Commission to its *value of the gas in place*, it appears that the Commission, in effect, has found the present value of the gas in place to be only 34/1000ths of one cent per Mcf. On a comparative basis, and using Wallace's $15,646,787.64 valuation as applied to the Commission's finding of 2,800,000,000 Mcf. recoverable reserve, the value of the gas in place is approximately ½¢ per Mcf.

The original "wildcat" cost to Canadian's predecessors in interest of five important leaseholds, containing approximately 47,000 acres, allowed by the Commission is $4,244.24, which is less than 10¢ per acre. (R., V. 5, 2735, 2736, 3051) Three of these leases are included at *zero valuation*. The present fair value of these same five leaseholds (exclusive of wells), as testified to by Wallace with supporting evidence as to such value, was $3,345,923. (R., V. 5, 3237, 3243) A similar situation exists in respect to the Commission's valua-

tion of the remainder of Canadian's leaseholds. (R., V. 5, 3051).

The Commission has wholly ignored all evidence of the market value of gas at the wellhead in the Texas Panhandle Field as a measure of the value of said leaseholds. Canadian's General Superintendent Ford testified that the market value of gas at the wellhead in the Texas Panhandle Field is not less than 4¢ per Mcf. on a 16.4-pound pressure base, or not less than 3.6¢ per Mcf. on a 14.65-pound pressure base. (R., V. 6, 3255-3281) This testimony was corroborated by Wallace, and by Commission's Exhibit 168, Sheets 13 and 127. (R., V. 6, 3281)[2] Ford's uncontradicted testimony showed the market value of Canadian's gas as a commodity at the Bivins Station (end of the gathering line and beginning of the interstate transmission line) to be 7¢ per Mcf. on a 16.4-pound pressure base, or approximately 6.3¢ per Mcf. on a 14.65-pound pressure base. (R., V. 6, 3255-3281)

It happens in this particular case that the application of the Commission's original cost theory to Canadian's gas leaseholds operates to the prejudice of Canadian. It might well have been the other way, in which event because of a high original cost the consuming public would be compelled to pay a higher rate notwithstanding the fact that the market value of the gas as a commodity would be the same, irrespective of the original cost of the leaseholds.

We submit that any theory which must end in such absurd results is inherently unsound and in conflict with the Fifth Amendment and violative of the principles announced by this Court in the Natural Gas Pipeline and Hope cases

[2]The Commission has found that Canadian's remaining recoverable reserves as of December 31, 1939, are not less than 2,800,000,000 Mcf.; that Canadian's future rate of production will be approximately 55,000,000 Mcf. (14.65-pound pressure base) per year; (R., V. 1, 159); and that on that basis Canadian's recoverable reserves will last for 63 years. The gross value of the 55,000,000 Mcf. to be so produced annually at 3.6¢ per Mcf. is $1,980,000. The Commission has found (R., V. 1, 171) Canadian's annual operating expenses to be $1,169,096, which includes gathering expense and transmission expenses, as well as producing expense. Even if all of this expense, however, be attributed to the production of gas at the wellhead and be deducted from the gross annual value of $1,980,000, there remains a net income of $810,904 for Canadian's gas production in one year, which is almost as much as the Commission has allowed in the rate base for the total of Canadian's leaseholds for all time.

and the question presented is of such over-all general importance as to justify and demand an exercise of the supervisory jurisdiction of this Court.

QUESTION NO. 3.

"3. Whether, even assuming, *arguendo,* that the Commission has rate regulatory jurisdiction over Canadian's production and gathering properties, facilities and business, and further assuming, *arguendo,* that it is proper in this case to include Canadian's leaseholds and wells in the rate base on the basis of original cost, the Commission can, consistently with the Fifth Amendment to the Constitution of the United States, the requirements of the Act, and the principles announced by this Court in the Natural Gas Pipeline, Hope and other cases, disallow and eliminate more than $3,000,000, plus interest during construction paid thereon, from the amount actually invested by Canadian in its original acquisition of production properties in about 1928 solely upon the ground that the sum so eliminated allegedly represented a profit between affiliated companies, and, therefore, formed no proper part of the cost of said properties, where the Record clearly demonstrates that the transaction resulting in the acquisition of said properties was not between affiliates and that the price paid therefor was not excessive."

The Commission in this case deducted from the actual investment of Canadian in gas leaseholds the sum of $3,370,817, as more fully hereinafter shown, on the ground that such sum represented "affiliated company profits" and, in addition thereto, the sum of approximately $245,000 interest during construction on such alleged profits. (R., V. 1, 149-151) In making this deduction from the actual investment in gas leaseholds, the Commission relegated Canadian to the provable costs of such leaseholds incurred by Amarillo Oil Company and its predecessors in title, which was the cost of such leaseholds prior to the time that any wells had been drilled thereon and prior to the time that it was definitely known whether any gas would ever be produced therefrom. At the time that many of said leaseholds were acquired the nearest oil and gas production was 200 miles

away. The Commission gave no consideration whatsoever to the fact that the leaseholds when acquired had little or no value and, therefore, only a nominal sum was paid for the same and wholly ignored the fact that said leaseholds possessed great value after the discovery of gas thereon and that such discovery and the increase in value necessarily precluded any use of the same for any character of public service. The Commission ignored the fact that said leaseholds were acquired by Canadian approximately 10 years after the original discovery of gas under such leaseholds and at a time when such leaseholds had a value far in excess of the original acquisition cost in their then "wildcat" and undeveloped state. The Commission also ignored the fact that the purchase of said leaseholds by Canadian resulted from an arm's length transaction, and also ignored the fact that there was no intimation whatsoever in the Record that Canadian paid an excessive price for such leaseholds. The action of the Commission, if carried to its logical conclusion, would deny the prospector or "wildcat" oil and gas operator the fruits of his discovery, whether the properties were sold or operated by him, and would necessarily limit him to the actual outlay of cash, without profit, in an extremely hazardous enterprise.

In 1917, over 27 years ago, a few ranchers and small business men residing in and about Amarillo, Texas, incorporated and organized a small corporation called "Amarillo Oil Company" (hereinafter referred to as "Amarillo") for the purpose of drilling a "wildcat" well for oil and gas in what has now become the great Texas Panhandle Field. (R., V. 5, 2837, 3040) At that time there had been no discovery of oil or gas within 200 miles of the proposed well location. (R., V. 7, 3673) Consequently, the cost to Amarillo of assembling the block of leases to be tested was purely nominal, except for drilling obligations. It was this purely nominal cost and no more that was included by the Commission in Canadian's rate base for such leaseholds as such, exclusive of development costs.

After many unfortunate experiences, financial and otherwise, the "wildcat" test well was finally completed in the Fall of 1918 as a gas well—the first commercial producer of either oil or gas in the Texas Panhandle Field. From

that humble and successful "wildcat" beginning, the Field has been subsequently developed by the drilling of successful test wells, until it now contains approximately 1,500,000 proven acres of gas lands on which there are located approximately 1,650 wells producing gas only and approximately 4,200 wells producing both oil and gas. (R., V. 1, 409) Canadian's acreage produces no oil.

As of August 1, 1924, Amarillo owned approximately 46,803 acres of developed leaseholds in which it had a total provable cost for the leaseholds as such, exclusive of the wells that had been drilled thereon, of approximately $4,244, or less than 10¢ per acre. (R., V. 6, 3038, 3051, 3040) As of that date it acquired 244,114 acres of leaseholds from Mountain States Gas Company, upon which wells had been drilled or were then drilling, and from that date to May 1, 1927, it acquired 3,998 acres from various other persons. (R., V. 6, 3051) It also acquired 30,235 acres from Mountain States which were classed as unoperated leaseholds, being leaseholds upon which no wells had then been drilled. (R., V. 6, 3063)

The leaseholds acquired from Mountain States Gas Company were paid for through the issuance of common stock. Such leaseholds had been acquired by Mountain States in an undeveloped "wildcat" stage and at the time of the acquisition by Amarillo there were located on such leaseholds five wells capable of producing natural gas and four wells that were then drilling which were later completed as gas wells. (R., V. 6, 3043) No gas had been sold from said leaseholds prior to that date. The total cost to Mountain States and its predecessors in title for the acreage acquired by Amarillo was $273,095.88 for the 244,114 acres of operated gas leaseholds, which included, however, approximately $76,318 for well drilling costs. (R., V. 6, 3041, 3042) When this sum is eliminated, the original acquisition cost of said leaseholds approximated $200,000, or less than $1.00 per acre. In fact, the largest leasehold involved, being the Bivins A 30, comprising 200,000 acres, had a provable cost to Mountain States of only $105,000 for the leasehold as such. This provable cost of less than $1.00 per acre was the entire amount included in the rate base for this block of very valuable leaseholds, exclusive of development costs.

The leaseholds above referred to that were included in the rate base for only a very nominal sum, and on the basis of their original "wildcat" provable costs, plus a very small amount of additional acreage, had an actual value of approximately $15,646,787.64 for the leaseholds as such, exclusive of all well costs, according to the uncontradicted testimony of Wallace. (R., V. 6, 3181-3254) Excluding the additional acreage the leaseholds above referred to had a minimum value of not less than $15,000,000 and were included in the rate base at a figure but little, if any, in excess of $300,000.

In 1924 Southwestern became the owner of all of the capital stock of Amarillo. Amarillo then owned leaseholds aggregating in excess of 300,000 acres. Additional test wells had been drilled and additional natural gas production had been developed.

It became apparent in 1927 that if Amarillo were to realize upon its extensive gas properties it must develop new markets of a substantial nature. Its only market at that time was for relatively small volumes at the wellhead for the City of Amarillo, Texas, and vicinity and one industrial sale at a plant near Amarillo. It had one well with a capacity substantially in excess of the volume required to supply its entire available market. (R., V. 1, 459)

Neither Amarillo nor its parent, Southwestern, had had any experience in the transportation of gas by pipe line over long distances and they also lacked the necessary capital with which to construct such a pipe line. (R., V. 1, 402, 403) The City of Denver, located a distance of approximately 350 miles from the Texas Panhandle Field, and intervening territory seemed to be the closest available market for natural gas in substantial quantities. (R., V. 1, 402) Southwestern approached Standard Oil Company (New Jersey) regarding the construction of a pipe line project to Denver and intervening territory. (R., V. 1, 403) Standard, after investigation, determined that the project was feasible and interested Cities Service who controlled the markets in Colorado. (R., V. 1, 403)

Negotiations were then commenced for the purchase of the gas leaseholds and wells of Amarillo, which negotiations

finally resulted in a contract dated April 5, 1927, whereby Amarillo was to receive $5,000,000 for its gas leaseholds, rights and wells. (R., V. 1, 403-416) *Neither Standard nor Cities Service had any interest whatsoever in either Amarillo Oil Company or Southwestern on that date (April 5, 1927), prior thereto or subsequent thereto. There was no corporate affiliation between any of the three participating companies which executed the contract of April 5, 1927. (R., V. 1, 460, 613-622) The contract was entered into only after long and continued arm's length negotiations between the parties. (R., V. 1, 493-526)* In accordance with the terms and provisions of said contract, Southwestern obligated itself to organize and incorporate a company (now Canadian), *separate and apart from its other companies and projects,* to which it would cause Amarillo Oil Company to convey, free of all debts, liens and encumbrances, all of the latter's gas leaseholds, rights and wells in the Texas Panhandle Field at the agreed price of $5,000,000. (R., V. 1, 381-400)

There were no negotiations whatsoever between Amarillo and Canadian with respect to the $5,000,000 transaction. Canadian was not actually organized until January, 1928, almost a year after the consideration had been agreed upon. (R., V. 1, 455) Amarillo, however, agreed and consented to carry out the agreement that Southwestern had made for it. (R., V. 1, 455, 456)

Southwestern, sitting on one side of the table, making the deal above referred to, had every incentive to get just as much as it could for the leaseholds, rights and wells of Amarillo and it tried to get more than $5,000,000. Likewise, Standard, on the other side of the table, which was not interested in Southwestern and which furnished all the money, had the incentive to bear down as much as it could on the price and actually tried to acquire the properties for less than $5,000,000. (R., V. 1, 460, 520) The negotiations with respect to the acquisition of the leaseholds covered a period of many months in 1926. (R., V. 1, 520-521)

The $5,000,000 paid by Canadian for the leaseholds was advanced in its entirety by Standard. (R., V. 1, 459) "* * * Southwestern Development Company was not taking five million dollars of its own funds and paying it to its own

subsidiary. * * * It got five million dollars of outside money." (R., V. 1, 450) Notwithstanding the arm's length character of the transaction which resulted in the sale by Amarillo and the purchase by Canadian, the Commission, nevertheless, ignored the entire transaction and determined that the provable costs of Amarillo Oil and its predecessors in title aggregated approximately $1,750,000, or about $3,250,000 less than the sum actually paid by Canadian. (R., V. 1, 150) Most of such provable costs, however, resulted from the drilling of gas wells and other costs incidental to the development of such leases. The provable cost of leases as such was very nominal as is hereinabove pointed out.

In arriving at such provable costs, the Commission ignored, among other things, the following:

1. A sum in excess of $50,000 expended in drilling a dry hole which was one of the early exploratory wells. (R., V. 5, 2850; V. 6, 3111, 3112) This well was as much a part of the development cost as the producing wells, but its cost was eliminated apparently because no one should be so foolish or imprudent as to drill non-producing wells.

2. $35,000 for interest on idle investment prior to October, 1920, when the first small volume of gas was sold. (R., V. 6, 3110-3111)

3. General overhead and administrative costs estimated at $68,000. (R., V. 6, 3108-3110)

4. Delay rentals paid on undeveloped leaseholds in a sum in excess of $488,000. (R., V. 6, 3106-3108)

If the principle of prudent investment as construed and applied by the Commission in this case to a mining enterprise such as the acquisition of "wildcat" oil and gas leases in an area more than 200 miles from known oil or gas production is followed consistently, it would result in the "wildcatter" or prospector being denied the value created by his discovery. This is true because if he attempts to sell the gas as such in interstate commerce for resale, the Commission, as it did in this case, would allow him only the provable "wildcat" costs of such leaseholds. If on the other hand he desired to sell the leaseholds to a company such as Canadian who desired to produce the gas and sell

he same for resale in interstate commerce, such company ould not afford to pay any more than the provable costs of such leaseholds in their "wildcat" state since the earnings would be limited to such provable costs. Certainly, it annot be said that the gas consuming public is entitled to ave rates fixed on any such basis, and, certainly, it cannot e said that rates fixed upon such basis are fair to the owner of the gas producing properties. In this case the Commission, through the application of accounting rules devised by t and which have no realistic application to a mining enterprise, actually excluded more than $600,000 as above pointed out, most of which was excluded on the theory that they had not been set up on the books in the first instance, notwithstanding the fact that such accounting procedure was unknown in so far at least as a mining enterprise was concerned at the time the expenditures were made. The delay entals in the sum of $488,000 were excluded by the Commission on the theory that Amarillo commenced selling some gas in the Fall of 1920 and that such expenditures were subsequent to that date. Clearly, such expenditures were absolutely necessary for Amarillo to keep its leaseholds in force and effect and were as much a part of the cost of such easeholds in a realistic sense as the original bonus price paid therefor. Clearly, the sum of in excess of $50,000 paid for a dry hole was also a real and definite cost incurred in the development of such properties. What incentive is there for a person to engage in the hazardous enterprise of drilling a "wildcat" well if he knows at the outset that if a well is dry he has lost the entire sum expended, but if on the other hand he is successful and discovers gas, still he will be permitted only to earn on the actual cost incurred in drilling the well, plus a small sum which he might have paid for the leaseholds in their "wildcat" stage. This, of course, does not tell the entire story. He would not even be permitted to recover the cost of drilling an exploratory dry hole. In other words, no one would be so foolish to embark on such an enterprise. He could not recover his money back no matter how successful his exploratory operations might be, and even though he discovered one of the greatest oil and gas fields that the world has ever known. Surely the Natural Gas Act does not require

and surely the Fifth Amendment prohibits any such irrational approach to the problem as this.

In addition to the original purchase from Amarillo, Canadian from time to time made other purchases of gas leaseholds, one of these being the purchase of the properties of Master Oil and Gas Company consisting of 5404.2 acres of leaseholds and two gas wells for the sum of $235,054.20. (R., V. 5, 2659-2661, 2815-2816) The Commission deducted from this purchase price the sum of $121,787. (R., V. 1, 150) This deduction was made on the ground that Prairie Oil and Gas Company owned 51% of the common stock of Master Oil and Gas Company and that N. K. Moody was a Director of both the purchaser and the seller. (R., V. 5, 2659-2661) No contention was made that the price was excessive. The Record is clear that in determining the so-called provable original cost of Master that Luttring, Commission witness, only went back to June 1, 1926, although the leaseholds were first acquired prior to 1920. (R., V. 5, 2659, 2823) There is nothing in the Record that would indicate that this was anything other than an arm's length transaction. There is no showing that the indirect relationship between Prairie and Canadian had anything whatsoever to do with the determination of the purchase price. Certainly, it cannot be said that Moody was in a position to in any sense dominate the action of the majority of the Board of Directors.

The Commission also deducted $244,853.26, being interest on the alleged excess over provable costs paid by Canadian to Amarillo. (R., V. 1, 149, Entry 249; V. 5, 2769) Obviously, if the entire $5,000,000 purchase price is allowed, the interest during construction actually paid upon this amount should also be allowed.

The Commission also deducted an additional sum of $128,000, being an alleged profit made by Mission Oil Company over and above actual provable costs (Mission is one of the predecessors in title of Amarillo). (R., V. 1, 150; V. 5, 3043-3051) Obviously, this deduction should not have been made if the full $5,000,000 purchase price is allowed.

The sum of the above deductions or eliminations by the Commission aggregates the sum of $3,615,670, which is ap-

proximately 36% of the entire undepreciated prudent investment rate base of Canadian as determined and allowed by the Commission (R., V. 1, 149) and almost 40% of the rate base determined by the Commission for Canadian in this case. (R., V. 1, 164)

The Circuit Court characterized the difference between the purchase price and the alleged provable original cost of predecessor companies as constituting a "synthetic inflation" and held in effect that the same was properly eliminated by virtue of *Pennsylvania Power and Light Company v. Federal Power Commission*, 139 Fed. (2d) 445, (certiorari denied). This case has absolutely no relevancy to the facts in the case at bar. It involved merely the proper method of keeping accounts by licensees under the Federal Water Power Act, which Act determines how such accounts should be kept. There is no such provision in the Natural Gas Act. In addition to this, however the *Pennsylvania* case involved a state of facts where a construction profit was being allowed to another company which was merely a puppet in the same holding company system. In fact, both parties were merely departments of one common holding company. That, of course, is not the situation with respect to Amarillo Oil Company. Amarillo acquired and developed the properties in question almost 10 years prior to the time they were sold to Canadian and in the interim increased the value thereof very materially as the result of exploratory drilling. The *Pennsylvania* case would be more nearly applicable on the facts if Amarillo had been employed by Canadian to go out and assemble the leaseholds after the Denver project had been inaugurated and then Canadian had paid Amarillo a profit for the work performed for it. It is too clear for argument that that is not the situation which now confronts this Court, yet that was the very situation involved in the *Pennsylvania* case. But even then, the case would not be applicable by virtue of the arm's length negotiations which transpired in the case at bar. Likewise, the various cases cited by the Commission in its answer brief to our petition for certiorari involved accounting principles for the most part by licensees under the Federal Water Power Act and also involve questions where a profit was made for actual construction work which was performed in reality by one department of a sys-

tem for another. Obviously, such cases have absolutely no relevancy to the facts in the case before the Court.

Even if the transaction whereby Canadian acquired the leaseholds and wells from Amarillo under the facts and circumstances existing in this case was one between affiliated companies, still the profit made by Amarillo Oil Company could not be condemned on that ground alone.

This very question has been recently decided by this Court in the case of *A. T. & T. Co., et al., v. United States, et al.*, 299 U. S. 232, 240, 81 L. Ed. 142. In that case Mr. Justice Cardoza, speaking for a unanimous Court, held definitely and positively that where properties were purchased from an affiliated company, or from a company that prior to the purchase had devoted such properties to a public use, that any profit made by the selling company could not be written off or ignored if, as a matter of fact, "*the difference between original and present cost is a true increment of value.*"

This principle has been reaffirmed in the recent case of *New York Telephone Company v. United States, et al.*, decided August 24, 1944, by a three Judge Court for the Southern District of New York. (Opinion not yet published) There was involved in that case the purchase of equipment by New York Telephone Company from its parent, the A. T. & T. Company. The latter company owned all of the common stock of the former. The book cost of the equipment involved to the A. T. & T. Company, less depreciation, aggregated $8,468,169.81 and was purchased by the New York Telephone Company for the sum of $12,634,680.38. The purchase price over the net book cost approximated $4,166,510.57. The Federal Communications Commission ordered the New York Company to write down the actual cost of the property in question to the net book cost of the selling company. The Court held that the purchasing company could not be required to write down the actual cost of the property if, as a matter of fact, it was worth the sum paid, citing the A. T. & T. decision by this Court referred to above.

It is true that these cases involve questions of accounting, but even so the underlying principle is applicable here. Cer-

tainly, there is no basis for eliminating almost $4,000,000 from the purchase price paid by Canadian to Amarillo if the principle decided by the above cases is sound. The entire $5,000,000 was actually paid and was paid in good faith and after prolonged negotiations between adverse parties. There is not even a suggestion that the property purchased was not worth every penny paid for it.

The *New York Telephone* case above referred to, being before a three Judge Court, will in all probability reach this Court by appeal. The issues in that case and in this case are so similar in principle that we earnestly contend that the scope of the review in this case should be enlarged to include this point 3 by virtue of the decision of the New York Court in the case referred to.

The Commission also relies heavily on the case of *Niagara Falls Power Company v. Federal Power Commission*, 137 Fed. 787, 793-794, (certiorari denied). That case involved the determination of the values of respective properties conveyed by the owners thereof to a common company and for which each of said owners accepted common stock in the same proportion that the value of the properties conveyed by each bore to the total value. In other words, this simply constituted a pooling of assets into one common operating company. No money whatsoever passed from the purchaser to the seller. Each of the so-called sellers still merely owned a portion of the combined assets. This was not true with respect to the sale by Amarillo to Canadian. Such sale did not constitute in any sense a pooling of assets, as suggested by the Commission. The purchase by Canadian was a condition precedent to the launching of the Denver project. The money paid belonged to Amarillo Oil Company and no contingency whatsoever could arise in the future which would affect its right to keep and retain the full purchase price. The project might have failed completely, but even so, Amarillo Oil Company would not have been affected, and neither would its parent, Southwestern, in so far as the $5,000,000 payment is concerned.

The pooling, if there were one, did not occur and could not have occurred until after provision had been made for the acquisition of the leaseholds and wells in question. If

we assume for the sake of argument that from that point on there was a pooling of assets, still this in no manner detracts from the fact that it was necessary for Canadian, as an alleged instrumentality of the project, to acquire from Amarillo the gas leaseholds and wells without which the project could not have been launched and without which no pooling of any character could have occurred. It was also necessary to pay to Amarillo the full $5,000,000 in cash, all of which was advanced by Standard and came from sources entirely outside of the Southwestern system. If we ignore the fact that the transaction at this stage was between non-affiliated concerns, still it makes no difference for the very simple reason that Southwestern had the perfect right to refrain from participating in the Denver project unless and until Canadian paid Amarillo $5,000,000 in cash for the properties acquired. The money paid was derived from sources entirely outside of the Southwestern system. The $5,000,000 belonged absolutely to Amarillo without regard to the future operations of the Denver project. The *Niagara Falls* case, therefore, and the principle decided there can have no relevancy whatsoever to this case.

As a matter of fact, the prudent investment theory, as applied by the Commission in this case, cannot be supported in any event if a rational view is taken with respect to the undisputed facts. Mr. Justice Brandies in his celebrated dissenting opinions defined original cost as the amount actually paid to establish the utility. He developed the theory that dollars were dedicated to the public service and not necessarily property. There is some reasonable and rational basis, of course, for this theory where the dollars invested actually constitute at the time the best evidence of value. That could not possibly be true in a mining operation such as this one where cost frequently has little relationship to value. The principle cannot apply also because the money invested by Amarillo and its predecessors in title in "wild-cat" leaseholds was not invested in any sense of the word in a public service enterprise. The investment was made in a mining enterprise and at a time and under such circumstances that it could not be known whether the property in question would ever produce natural gas. The great increase in value occurred by reason of the discovery of large

deposits of natural gas. This necessarily preceded any sale of gas in interstate commerce or otherwise. Therefore, Amarillo and the others did not invest money or dedicate money in a public utility or in a public enterprise of any character. It is true that when Canadian acquired the properties from Amarillo that it did so for the purpose of producing and selling gas in interstate commerce. This was the first time that any money was invested or dedicated with respect to a particular project of a public service character and is the very minimum dollar figure, therefore, that can be said to have been dedicated to a public service operation and represents the very minimum prudent investment or original cost figure that can be applied as of that date. The Court will bear in mind that even then the transportation and sale of gas in interstate commerce was not affected with a public interest and did not become so until the Natural Gas Act was passed in 1938.

If we assume, therefore, that the prudent investment theory may be applied to a natural gas production operation after discovery has already been made and where the properties were acquired for the purpose of engaging in a public service operation, still a rate base cannot be determined on such principles with respect to the producing leaseholds here involved, if a rational and realistic viewpoint is assumed.

This Court has said in the *Natural Gas Pipeline* and *Hope* cases that the Commission is not restricted to any particular formula or combination of formulas in arriving at a rate base. These opinions, however, clearly demonstrate that the formula or combination of formulas adopted by the Commission shall bear some reasonable relationship to the admitted facts in any given case. This is clearly demonstrated in the concurring opinion by Justices Black, Murphy and Douglas in the *Natural Gas Pipeline* case wherein it is stated: "The Commission has a broad area of discretion for selection of an appropriate rate base. * * * Various routes to that end may be worked out by the expert administrators charged with the duty of regulation. * * * *The decision in each case must turn on considerations of justness and fairness which cannot be cast into a legalistic formula.*" (pp. 606-607) (Italics supplied)

The "legalistic formula" adopted by the Commission for inclusion of Canadian's leaseholds in its rate base has resulted in the assignment of a zero valuation to some of Canadian's most valuable leaseholds and a value of only 10¢ per acre to a still greater block of important leaseholds, and a nominal value of not to exceed $1.00 per acre on the great majority of its leaseholds. The undisputed testimony demonstrates that these leaseholds were worth many millions of dollars, exclusive of the wells. Clearly, the Commission's "legalistic formula" in this case does not meet any test of "justness and fairness".

The fact that this Court has said that the Commission is not restricted to any particular approach for the purpose of determining a rate base does not mean that the Commission can close its eyes to the actual facts existing and produce a result entirely inconsistent with such facts and one which bears no reasonable relationship to the actual realities with respect to the problem before it. This is particularly true where the owners of leaseholds, as in this case, engaged in an extremely hazardous "wildcat" enterprise in search of oil and gas. They paid little for their leaseholds at the outset because such leaseholds had little or no value at the time of their original acquisition. The value was developed by exploratory operations and discovery, which preceded by almost 10 years the purchase of such leaseholds by Canadian, and which preceded by 20 years the enactment of the Natural Gas Act which for the first time subjected to regulation the transportation and sale of natural gas in interstate commerce for resale. Certainly, the public interest does not require that the consumers of natural gas produced from such properties be given the entire economic benefit resulting from the extremely hazardous undertaking involved in the discovery and subsequent production of natural gas under such circumstances. Certainly, no one will engage in the business of drilling a "wildcat" well 200 miles from any known oil or gas production, as Amarillo did, if the return upon such undertaking is to be limited literally to 6½% on the cost of the hole in the ground. We submit that neither the public interest nor the Natural Gas Act requires and the Fifth Amendment prohibits a rate regulatory process based upon any such theory.

The Commission, however, notwithstanding the above, suggests in its answer brief to our original petition for certiorari that the alleged profit made by Amarillo was carried on Canadian's books as "appreciation" and that no income taxes were paid on such profit. This has no significance whatsoever. At the time of this transaction, Southwestern had theretofore elected to file Federal income tax returns for itself and subsidiaries on a consolidated basis. Consequently, any profit realized by Amarillo in the transaction was eliminated for income tax purposes in the consolidated return. (R., V. 5, 2638) At the same time, however, such elimination of taxable profit resulted in a lower depreciation and depletion base for Canadian's future use for tax purposes which in the long run might require the payment of more, rather than less, Federal income taxes. This is the whole story concerning this transaction. Certainly, this method of handling the transaction for income tax purposes and for the purpose only of reflecting the depreciation base does not change the arm's length nature of the transaction as reflected by the uncontradicted evidence and, certainly, it does not in any way detract from the fact that Canadian in good faith paid $5,000,000 for the property, and neither does it detract from the fact that the property was worth every dime paid for it. This, as stated in the *A. T. & T.* and *New York Telephone* cases above referred to, is all that really counts. Neither does it indicate a write-up in any sense as intimated by Commission because, among other things, it did not result in any entry whatsoever in the surplus account. It would have been reflected there had it been a write-up. (R., V. 5, 2637) No matter how Canadian may have kept its books of account for tax or other purposes, and notwithstanding any evidence of the true arm's length character of the transaction, and of the true value of the property, it is obvious that the position of the Commission and its staff would have remained the same, simply because it was a transaction, they say, between affiliated companies.

We earnestly contend that the undisputed facts in this case demonstrate that the transaction whereby Canadian acquired the leaseholds, rights and wells of Amarillo was one between non-affiliated companies and that every safeguard necessary to insure a fair price and render the transaction invulner-

able was present and operating here. There is not an intimation in the Record that the price paid was excessive and, as a matter of fact, the evidence would justify a much higher consideration than that actually paid. There is not and could be no question with respect to devotion of such properties to a public use prior to the time that the sale was made. Amarillo's only sales were at the wellhead and to industrial consumers, neither of which is affected with a public interest. Furthermore, the sales made by Canadian in interstate commerce for resale were not affected with a public interest until the passage of the Natural Gas Act in 1938, 20 years after most of the property was acquired by Amarillo and its predecessors in title and more than 10 years after the purchase of the same by Canadian. We furthermore earnestly contend that in any event the undisputed facts and circumstances in this case demonstrate clearly that the prudent investment theory as developed, construed and applied by the Commission in this case produces such absurd and unrealistic results that it cannot be applied in this case for the purpose of determining the rate base of Canadian with respect to leaseholds as such. If such theory is to be applied at all, it cannot be applied to the "wildcat" cost of such leaseholds incurred by Amarillo and its predecessors in interest. The very minimum cost of leaseholds under such theory in any event with respect to the leaseholds acquired from Amarillo is the actual money paid therefor by Canadian in 1928. In other words, the full \$5,000,000 paid for such leaseholds, rights and wells should be included in the rate base.

It is submitted that the action of the Commission and the affirmance of such action by the Circuit Court in eliminating almost \$4,000,000 of Canadian's actual cash investment in its gas producing properties from its rate base and denying Canadian any return on such sum, as well as the right to recover such sum through the sale of gas, violates the provisions of the Fifth Amendment and the Act and is probably contrary to the decisions of this Court in the *Hope* and *Natural Gas Pipe Line* and other applicable cases hereinabove referred to. It is also submitted that the question here involved presents a Federal question of great and far reaching importance which has not been, but which should be, settled.

by this Court, and which question will likely arise in other cases in the administration of the Act; that the Commission in its action and the Circuit Court by its affirmance of such action have so far departed from accepted procedures as to call for an exercise of this Court's power of supervision; and that this Court, therefore, should grant this motion for re-hearing and enlarge the scope of review so as to include said Question No. 3 hereinabove quoted.

Respectfully submitted,

P. C. SPENCER,
Room 2759, 630 Fifth Avenue,
New York, N. Y.;

CHARLES H. KEFFER,
903 Fisk Building,
Amarillo, Texas;

JOHN P. AKOLT,
1300 Telephone Building,
Denver, Colorado,
Attorneys for Petitioner.

CERTIFICATE OF COUNSEL.

I, John P. Akolt, of the City and County of Denver, State of Colorado, being one of counsel for Canadian River Gas Company, petitioner in the above petition named, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

JOHN P. AKOLT,
Attorney for Petitioner, Canadian River Gas Company.